

The Black Box: Unraveling Family Business Succession

ABSTRACT

Using the family business succession, resource-based view of firms, *familiness*, and organizational clan literatures, this article develops a model based the ability of the family business to use *familiness*, a specific bundle of attributes deriving from a family's culture, as a competitive advantage for the family firm. In particular, this resource-based framework of family business shows how *familiness*, as a competitive advantage, may distinguished between family firms that succeed beyond the second generation and those that do not. Implications for future research are discussed.

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INTRODUCTION

Recent research on family firms suggest that they outperform non-family firms (Anderson, Mansi, & Reeb, 2003; Miller & Le Breton-Miller, 2005; Villalonga & Amit, 2004). Despite this, family business succession remains a black box and among the most critical research questions facing family business researchers. Despite a plethora of research in this area, succession rates among family businesses remain low. While the explanations for this have been widely debated, e.g., Handler (1992) and Sonnenfeld (1988), no clear consensus has emerged. We propose an alternative approach to the question of family business succession that synthesizes the resource-based theory of the firm, family culture, and organizational clans. We attempt to answer the call by Chrisman, Chua, and Steier (2005), in part, for research to better understand the issues surrounding the concept of familiness.

The definition of family business for the purposes of this research is “a business governed and/or managed with the intention to shape and pursue the vision of the business held by a dominant coalition controlled by members of the same family or a small number of families in a manner that is potentially sustainable across generations of the family or families” (Chua & Chrisman, 1999, p. 28). They argue that a family business is distinguished from others, not on the basis of the components of family involvement, but by how these components are used to pursue the family’s vision. Indeed, “The vision provides the context, meaning, and reason for family involvement just as a strategy

provides the context for the functional policy decisions of the firm” (Chua & Chrisman, 1999, p. 31).

This study examines the differences between family-controlled firms that fail or are sold in the second or later generations with persistently successful family-controlled firms.

What causes some family firms to remain healthy and within the control of the founding family, while other family firms cease to exist or pass out of the founding family’s control? We examine family owned firms within the framework of the resource-based theory of the firm, in which the search for rare, valuable, imperfectly imitable, non-substitutable resources has led researchers to consider a variety of intangible resources (Barney, 1991). We discuss family culture as an intangible resource that may be the key to family business longevity. When family cultures are transferred within family firms, the family culture may become a resource that confers a competitive advantage.

Furthermore, family cultures will differ among families, and not all family cultures will generate equal competitive advantages. The article posits that these differences between family cultures may explain why some family firms remain successful and remain within the founding family and the implications these factors may have on succession.

LITERATURE REVIEW

Resource-Based Theory of the Firm

The resource-based view of the firm argues that firms differ in their performance because of differences in their resources that are valuable, unique, and cannot be imitated. Such resources may be the basis for a sustainable competitive advantage (Barney, 1991).

While resources can be either tangible or intangible, intangible resources are more likely to produce a competitive advantage because they are often rare and socially complex, thereby making them difficult to imitate (Barney, 1991).

Organizational culture is more directly considered by Hall (1992, 1993). He argues that “intangible resources range from the intellectual property rights of patents, trademarks, copyright and registered design; through contracts; trade secrets; public knowledge such as scientific works; to the people dependent; or subjective resources of know-how; *organizational culture*; and the reputation of product and company” (Hall, 1992, p. 135). Hall (1992) argues that culture applies to the entire organization and includes habits, attitudes, beliefs, and values that permeate the individuals and groups which comprise the organization (Hall, 1992). We agree with Zahra, Hayton, and Salvato (2004) that the culture of a family business is derived from the culture of the controlling family, and may be the basis of a competitive advantage.

Family Business Succession and Family Culture

A summary of the literature on family business succession suggests that our understanding of family business succession is somewhat limited to an understanding of some of the behavioral and psychological factors involved. While much of the succession research focuses on behavioral issues surrounding the succession process, Dyer and Handler (1994) recognize the need for more comprehensive models that include how various dynamics of succession relate to one another to form an understanding of the complexity and the processes. Adapting from Hall (1992), we define family culture to be

the habits, attitudes, beliefs, and values which permeate the individuals comprising the family. Family culture provides a convenient referent to the resource-based theory of the firm. Each family has its own unique family culture. When this family culture manifests itself as an intangible resource it provides the basis for a competitive advantage. We call this unique form of family culture, *familiness*. *Familiness* is an imperfectly substitutable/imperfectly exchangeable resource in the manner described by Barney (1991). In some families, the family culture may be a strength, but not necessarily a rare, imperfectly imitable, non-substitutable resource (Barney, 1991), while in other families it will become a competitive advantage. As family cultures differ from one another and from corporate culture, so may the competitive advantage conferred by this resource differ, thereby partially explaining why some families firms remain viable and within family control while others do not do so.

Family-controlled firms may possess advantages relative to non-family-controlled and other family-controlled competitors which are not directly related to family culture. However, in this article, we focus on certain aspects of family culture as a source of competitive advantage. A family's culture may create goal congruence among family members, and a shared view of the world, the desired future, and a shared will for the family to succeed, even at the expense of personal goals. Families are also adept at identifying shirking and unsociable behavior. The family will punish or correct the offender. Should this tacit family culture be transferable to the family firm, it may provide an imperfectly exchangeable resource allowing for a persistent competitive. Furthermore, those families most proficient with these skills—when those skills are

transferred within family businesses—will be the family businesses most likely to succeed and remain under family control. Not every family culture will be as effective at these tasks, nor will family culture remain static through generations. As family cultures differ and evolve through generations, so may the competitive advantage conferred by family culture differ, thus helping explain observed family business succession patterns.

Familiness and Family Business Culture

Closely related to the concept of family business culture is the term “familiness.” Familiness may be defined as interactions between the family members, family unit itself, individuals and the business that lead to positive synergies; this creates competitive advantages for the firm (Habbershon, Williams, & MacMillan, 2003). Chrisman, Chua, and Sharma (2005) took the definition one step further by suggesting that families form firms to do just this—to institutionalize their unique resources and capabilities for financial, and in some cases, non-financial motives in a strategic management theory framework. The social element of the family is of major importance in understanding why family firms organize and persist over time, from one generation to the next. Nordqvist (2005) looked at the behavioral effects of top management teams from a familiness perspective and cited this as a unique advantage. The topic of familiness was important enough for *Entrepreneurship Theory & Practice* to devote an entire issue to the topic in May of 2005. Chrisman, Chua, and Steier (2005) in the opening article of the special issue call for more research to further define familiness by understanding the conditions that lead to this phenomenon, the formation of family firms, and why they are

successful. This article is an attempt to answer this call, in part, to the black box question of success and succession.

“Effective” Family Culture

Family culture in itself may be considered a competitive advantage. Successful family firms—ones that remains competitive and under family control—will share family cultures that foster goal congruence among family members, and a shared view of the world, the desired future, and a shared will for the family to succeed, even at the expense of personal goals. These successful family cultures will be adept at identifying shirking and unsociable behavior. They will punish or correct the offender. For brevity’s sake, we refer to such family cultures as “effective.”

Families are likely to develop such effective cultural traits because of their long, stable membership, potent anti-shirking practices, and overlapping utility functions. A family member’s well-being depends on the well-being of other family members and the family firm as an entity. Conditions conducive to development of effective cultures are frequently present and passed on during socialization periods of families. These would include a long history of intensive interaction, stable membership, and an absence of perceived institutional alternatives. This creates the ability in families to align incentives and produce decisions in harmony with collective interests, skills that some families will be able to transfer successfully to a family-controlled business.

Some families display a remarkable ability to induce individuals to identify self-interest with collective interest. Family businesses are often better able to align incentives than non-family organizations. This is because of the fondness, affection, love, sense of duty, and willingness to sacrifice often engendered by the family. Thus, family business members are more likely to care about the family business' prosperity than non-family business employees. Once again, this ability will vary among families. The strength and effectiveness of these family bonds may be modulated by external capital market and/or social constraints facing the family. For example, consider the traditionally under-served populations in the U.S. They include, but are not limited to, recent immigrants, women, persecuted minorities, young people with good ideas but no formal credit history. We note in passing that if there were no social and/or no capital market constraints then the process of "red-lining" by banks would not exist and would not be illegal.

Also, when a family member deviates from the family culture, families have powerful abilities to detect and reduce unsociability within the family. Family members know when someone is shirking. Furthermore, families are able to apply incredible leverage on the shirker to get him to amend his behavior. Such abilities will be difficult to replicate in the market because they are based on association and intense interpersonal interest. It also seems likely that families *differ* in their ability to detect, admit and limit shirking. This ability is likely intensified by limited access to capital markets, linguistic or other cultural barriers. Therefore, those families may more creatively monitor and limit shirking. The families that control shirking will be more successful at transferring these skills from the home to a family-controlled business. These traits form an effective family

culture. When family members enter the family business, they have been pre-socialized at home and are able to bring this shared culture into the business. Our “effective family culture,” when transferred to the family business, forms the basis “familiness” in the family firm.

However, these family cultural mechanisms are tacit. They may not be transferable to outsiders, or persistent through generations. Thus family culture provides a foundation for the family firm. If the family culture is an effective culture, *ceteris paribus*, this family culture forms a lasting competitive advantage. Moreover, families will differ in these abilities, and the family culture itself will evolve over time. That is, the value of a family culture will differ from family to family and may not persist over time. Therefore, we expect family firm survival rates and succession to differ accordingly.

Thus, families whose tacit family cultures demonstrate greater degrees of intergenerational altruism and more efficient unsociability correcting practices should be more effective. Families who transfer their tacit “effective family culture” to the family business will exhibit more “familiness” within the business. Businesses with more “familiness” will have a competitive advantage, *ceteris paribus*. Therefore, these families should be more likely to retain the family business within the founding family.

Moreover, the value-added from family culture should vary, both over time and from family to family, regardless of whether the family and family firm under discussion is composed of recent immigrants. Figure 1 illustrates the relationship between *family*

culture, familiness and firm succession in the family business. Please note that Figure 1 is not a formal model but is a schematic illustration.

(Figure 1 about here)

DISCUSSION

The next step is to test the model most likely through a survey method that would address several variables in the model. The first variable will ensure that the firm is a “family firm” in the sense of Chua and Chrisman (1999), and further defined in this paper. The second variable would be to gauge family interest in continuing the business. To what extent does the current generation have an interest in continuing the business as a family firm? And, to what extent does the coming generation express an interest in taking over the firm and maintaining it as a family firm? The third variable would be to measure the effectiveness of the family’s culture, both within and away from the business. To what extent do family members share specific goals? To what extent do those goals extend to the family firm? To what extent are family members willing to identify self-interest with the family’s well-being? To what extent are individual family members willing to place family goals ahead of personal goals? To what extent does the family tolerate unsociable behavior among family members? How effectively does the family rein in unsociable behaviors among family members? Information on the market conditions and the profitability of the firm over time would also be collected. An empirical model relating the effective family culture / “familiness” business culture to the intention of continuing the business as a family business over time could then be formed with performance

factors considered. It is important to understand that this variable must be able to distinguish between family culture, in general, as merely a strength, or even a weakness, of the family business, and as it is manifested as *familiness*—the specific bundle of imperfectly substitutable, non-marketable characteristics which confer competitive advantage.

Any empirical test of the concept of familiness must also consider other potentially explanatory variables, such as tangible resources and the institutional environment. Tangible resources would be measured by asking about the degree of value attributed to tangible variables such as location, distribution channels, patents, etc. as discussed by Barney (1991). Institutional environment would be measured by seeking feedback from respondents on the availability of assistance programs and legal assistance available to the family business, the burden of taxes, regulation, corporate and government corruption, and so forth. Continuing to evaluate the model, we would also need to evaluate the presence of barriers. Factors such as time, the mix of non-family members in the firm, the size of the firm, and market conditions would be measured. For example, respondents would be asked the percentage of non-family members in the business.

As a means to illustrate the model, we consider immigrant families. Immigrant families serve as a convenient referent to this model. Immigrant families face numerous obstacles in the ordinary labor market. Self-employment is often a viable route around those obstacles. Furthermore, immigrant family members face fewer viable alternatives outside of the family, and that immigrant families may be better at identifying and correcting

unsociable behavior. These traits will be positively correlated with effective family culture, and a high degree of “familiness” in the family businesses. However, as we have argued, these traits are not expected to remain stable across generations. This is especially true for immigrant families as they become assimilated into the general culture. Therefore, we would expect higher initial formation rates and initial succession rates of family businesses among immigrant families. However, we would also find support for our argument if the succession rate of immigrant family businesses declined over time, converging to the society mean as the effectiveness of the family culture declines over time. Importantly, researchers would need to consider that many immigrant family firms are not intended to last beyond the first generation. Immigrant families often choose self-employment as their entry into a society, but want something different for their children. This suggests the application of the Heckman Model (1976, 1979) of sample selection bias.

SUMMARY

Dyer and Hanlder (1994) and Chrisman, Chua, and Steier (2005) called for more comprehensive models of family business succession to better understand the complexity and the processes involved. Using the family business succession, resource-based view of firms, *familiness*, and organizational clan literatures, this article developed a model based on the ability of the family business to use specific aspects of family culture, *familiness*, as a competitive advantage for the family firm. In particular, this resource-based framework of family business shows the relationship between *familiness*, as a

competitive advantage that distinguishes between family firms that succeed beyond the second generation and those that do not. This article attempts to propose a more comprehensive model of family business succession by summarizing the current literature on family business succession, family culture, and the resource-based view of firms to form a testable framework that identifies family culture as the core strategic advantage of the family firm. Effective family culture is transferred to the family firm, manifesting itself as *familiness* in those firms. This transference is predicted to increase the likelihood of multi-generation family business succession and answers the call for better understanding of the concept of *familiness*. While the article is limited to the introduction of a new theoretical framework of the family business, it provides a first step at uncovering the black box of family business succession issues.

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FIGURE 1: Family Culture, *Familiness* and Succession in the Family Business

